STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of NEWS AMERICA PUBLISHING, INC. for Revision of a Determination or for Refund of Tax on Gains Derived from Certain Real Property Transfers under Article 31-B of the Tax Law.	: : : : :	DETERMINATION DTA NO. 810530

Petitioner, News America Publishing, Inc., 1211 Avenue of the Americas, New York, New York 10036, filed a petition for revision of a determination or for refund of gains derived from certain real property transfers under Article 31-B of the Tax Law.

A hearing was commenced before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York on September 19, 1994 and continued to completion on September 20, 1994. Petitioner and the Division of Taxation filed briefs on November 28, 1994 and January 6, 1995, respectively. Petitioner filed a reply brief on January 27, 1995 which began the six-month statutory period for issuance of a determination.[1] Petitioner appeared by Squadron, Ellenoff, Plesent, Sheinfeld & Sorkin (Neal M. Goldman, Esq., and Scott Friedman, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Herbert M. Friedman, Jr., Esq., of counsel).

ISSUES

I. Whether an asset purchase agreement between petitioner and the transferee in a transaction which included the sale of real property, tangible personal property and intangible

[1]The Division of Taxation submitted a letter responding to petitioner's reply brief on February 6, 1995. Inasmuch as the Division of Taxation did not seek permission to file a responsive brief and no provision was made for one at the hearing, the letter was not considered in arriving at a determination.

property provided a reasonable apportionment of the consideration for the real property.

II. Whether, if there was no reasonable apportionment of the consideration, the Division of Taxation properly determined the fair market value of the real property.

III. Whether petitioner has established that penalties assessed against it should be cancelled.

FINDINGS OF FACT

Petitioner, News America Publishing, Inc. ("News America"), is an indirectly, wholly-owned subsidiary of The News Corporation Limited whose chief executive is Rupert Murdoch. Until March 1988, News America was the owner and publisher of the New York Post, the oldest continuously published daily newspaper in the United States. A predecessor corporation of News America purchased the Post in 1976.

The real property owned by News America and used as the headquarters and publishing center of the Post is located at 210-218 South Street in lower Manhattan. Approximately 75% of the 1.58 acre site is occupied by a one, two and six-story manufacturing/loft building, originally built by the Hearst corporation in 1927 as a newspaper production and distribution plant. The building has always functioned in that capacity.

At the time the Post was purchased by News America, a Fair Market Value Report was prepared by Coats & Burchard Company where the real property was valued as follows:

Land	$ 17,400.00
Land improvements	11,088.00
Building	9,223,912.00
Total	$9,252,400.00

In 1985, an affiliate of News America acquired the license to operate a television station, now called WNYW, in the New York City metropolitan area. Under cross-ownership regulations of the Federal Communications Commission ("FCC"), News America was not allowed to own both a television station and a newspaper in the same metropolitan area. News America sought and was granted a waiver of the cross-ownership regulations; however, the waiver was about to expire in the fall of 1987. As a result, petitioner was forced to divest itself of the Post prior to March 1988.

News America retained an investment banker, Allen & Company, Inc., to prepare an offering memorandum describing the Post, its business and its assets. The Allen & Co. offering memorandum contains descriptions of: the newspaper market in the New York City metropolitan area; the Post's business, including its editorial policy; circulation, promotion and distribution of the newspaper; the Post's advertising revenues and policies; the Post's property, plant and equipment; its human resources and labor relations programs, including its collective bargaining contracts and pension and welfare plans; opportunities to improve performance of the newspaper business; and a financial summary. Excluding various tables and charts, the entire offering memorandum is 28 pages long. The real property which was included in the offering is described in the memorandum as follows:

> "The 210 South Street property consists of a newspaper plant, offices and a parking lot located on South Street between Catherine Slip Street to the south and Market Slip Street to the north. Fronting along the Franklin Delano Roosevelt Drive and the East River, the property is just north of the South Street Seaport and within one-half mile of the Wall Street financial district. The property is located in a high density area of mixed land use, primarily office and residential. Accessibility to the immediate area is excellent, and the property is located within one mile of four major traffic arteries. The total site area contains 68,867 square feet, all of which is owned in fee simple. The building occupies approximately 47,655 square feet of the plot. A parking lot is located behind the building and runs adjacent to Water Street. Portions of the fourth, fifth, and sixth floors are currently used by News America for corporate headquarters but will be available for lease to another tenant after the sale. The Post uses the remainder of the space.
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> "The building, constructed in 1927, has been well maintained. The gross rentable area is approximately 241,579 square feet. . . . The Post also leases, at an annual cost of $205,000, all the land located under the FDR Drive from the south side of Catherine Slip Street to the north side of Market Slip Street which encompasses a land area of approximately 83,000 square feet and provides parking for about 270 cars. This lease expires on October 4, 1989.
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> "The entire property has recently been appraised at a value of approximately $35 million. The appraisal is available for review upon request."

Table XXVII of the offering memorandum is a balance sheet which attributes the following book value to the Post's property and equipment as of June 28, 1987:

Land	$ 817,000.00
Buildings	11,461,000.00
Equipment	24,929,000.00
Total Cost	$37,207,000.00

Accumulated Depreciation		(20,986,000.00)
Net Property and Equipment	$16,221,000.00	

The appraisal referred to in the Allen & Co. memorandum was prepared by Wm. A. White/Tishman Realty East, Inc. (White/Tishman) at the request of Allen & Co. (the "Tishman Appraisal"). It was authored by Robert Von Ancken, a member of the American Institute of Real Estate Appraisers as well as numerous other professional organizations. The stated purpose of the Tishman Appraisal was to estimate the fair market value of the real estate, exclusive of furniture, fixtures and presses. Fair market value is defined in the Tishman Appraisal, in pertinent part, as "[t]he most probable price in terms of money which a property should bring in a competitive and open market under all conditions requisite to a fair sale. . ." (Tishman Appraisal, p. 23). The Tishman Appraisal's estimate of the fair market value of the Post real property is based on its determination of the highest and best use (essentially, the most profitable use) to which the real property could be put. The highest and best use for the Post real property was said to be redevelopment for residential use. Since the property is zoned for industrial and commercial use, the Tishman Appraisal concluded that the alternative highest and best use would be as a commercial office building.

The Tishman Appraisal states that the Post building is adaptable to a wide range of purposes including, residential apartments, office space, a television studio, a hospital, a transient hotel and a publishing plant. The appraisal goes on to evaluate the demand for land to be used for such purposes. It rates as excellent the demand for land with a view of the East River and lower Manhattan to be used for residential housing. It rates as good the demand for institutional buildings for use by government entities. Concerning the demand for office space, the Tishman Appraisal states:

> "The demand for secondary office space near downtown has been static. Much of this type of space now exists in the older loft buildings of midtown south at rents of $20-$26 per square foot. The absorption has been slow after a quick pace in the initial stages during 1982-1985. Places such as downtown Brooklyn are able to offer new space at rents of $25.00/sq. ft. and reconditioned office space (Fulton Landing across River from subject) at $25.00/sq. ft. gross because of tax concessions and reduced electric costs." (Tishman Appraisal, p. 44.)

Assuming the highest and best use of the property to be for commercial office space, the Tishman Appraisal used three approaches to value the Post real property.

(a) The Income Approach. This approach was described as follows:

> "The Income Approach is based on the theory that value is the present worth of future benefits. The future benefits of ownership consist of the present value of the net income which will accrue to the holder of the property during the period of ownership plus the reversion of the property at the end of the investment holding period." (Tishman Appraisal, p. 62).

Using the Income Approach, the Tishman Appraisal began by estimating the gross potential income of the property as leased office space. The Tishman Appraisal projected that the Post real property could achieve an average rental of $22.00 per square foot inclusive of the parking area and $40.00 per square foot for the three-story high printing and storage area of the building. This approach to valuation indicated a value of $30,700,000.00.

(b) The Market Approach. This approach involved a comparison of the Post property with sales of fairly large loft buildings that were converted to office use after their sale. According to Mr. Von Ancken, comparable sales indicated a value of $135.00 per square foot of gross building area after adjustments for location, the age and condition of the Post building, building height and configuration. The Market Approach indicated a value of $35,600,000.00.

To reach the result he did, Mr. Von Ancken reviewed the sales of 10 office buildings deemed comparable to the Post building. Three were sold for amounts that computed to less than or equal to $82.17 per square foot. Four were sold for between $99.00 and $109.88 per square foot, and the remaining three were sold for $120.91 per square foot, $127.72 per square foot and $177.26 per square foot (this last building is located on Fifth Avenue across from Union Park near 16th Street). The Tishman Appraisal explains its valuation as follows:

> "The subject property is in an overall condition that is superior to most of these loft building sales, however, its location is isolated from other business uses and access to public transportation is only adequate. We have used the loft building sales at the high end of the range and made an upward adjustment to reflect the superior condition of the recently built executive offices on the 5th and 6th floors (+15%), plus the extra land on the site, the potential for enlarging the building, and the land leased across the street for parking (+5). The indicated unit value for the subject is $137.50/sf." (Tishman Appraisal, pp. 71-72).

(c) Market/Sales Comparison Approach. Using this approach the Tishman Appraisal valued the property as if it were vacant land. For commercial use, Mr. Von Ancken estimated a land value based on comparable sales of $50.00 per square foot. Using a total FAR (floor area ratio) of 688,670 square feet, the maximum number of square feet that would be allowed for the real property, Mr. Von Ancken calculated a value of $34,400,000.00. Mr. Von Ancken determined that this valuation could be increased to $41,300,000.00 if the buyer could obtain a zoning variance allowing the construction of residential units.

The Allen & Co. offering memorandum and the Tishman Appraisal were made available to potential purchasers. At least four parties responded with preliminary bids ranging from $20 million to $40 million. Each of the bids was for the Post as an ongoing business; none was for the real property alone. All of the bids were contingent upon the negotiation of satisfactory bargaining agreements with each of the Post's unions. In the end, however, the only serious bidder was Peter Kalikow, an individual who was well known in the New York City area as a successful and prosperous real estate developer.

The negotiations which led to the purchase of the Post by Kalikow Media Incorporated ("KMI"), a corporation owned by Peter Kalikow, were described by Daniel F. Cremins, the chief operating and financial officer for Mr. Kalikow's real estate companies. Mr. Cremins has worked for Mr. Kalikow since 1975. His academic education was in the field of accounting, and he has worked from the time of his graduation from college in the area of real estate development. His position immediately before going to work for Mr. Kalikow was as the chief financial officer for a luxury high-rise development project in Iran. Mr. Cremins described Peter Kalikow at the time of the Post purchase as a man who had enjoyed inordinate success in the real estate market and who saw in the Post a new outlet for the expression of his creative energies.

Mr. Cremins asked Mickey Tarnepoll, a senior managing partner at Bear Stearns, Kalikow's investment banker, to evaluate the Allen & Co. offering memorandum. Mr. Kalikow and Mr. Cremins relied on their own expertise and experience to determine the value of the Post real property. The first thing they did after reviewing the Tishman Appraisal was to pay a visit to the Post property. After viewing the property, they disagreed with the appraisal. Mr. Cremins stated that the location of the Post building, its distance from public transportation and the lack of suitable parking facilities made it unsuitable for residential or commercial office development.

The Post building faces the East River. A bulkhead or retaining wall is built along the waterfront. The City of New York operates a parking lot between the river and the street in front of the Post building. An elevated portion of the FDR Drive is directly over the street and shadows the lower floors of the Post building. The building is located between the Brooklyn and Manhattan bridges and is surrounded by several low to middle income housing projects, including Knickerbocker Village, the Alfred E. Smith Houses and Rutgers Houses, which effectively wall off the Post building from the neighborhoods beyond it. Mr. Cremins described the immediate vicinity of the Post as a "tough", crime-ridden neighborhood. The nearest subway station or bus stop is approximately a 20-minute walk from the Post. The leased parking space directly across the street from the Post building was poorly maintained and filled with potholes.

Mr. Kalikow entered into negotiations for the purchase of the Post with the intention of publishing a newspaper. He never had any interest in purchasing the Post building to develop it for residential or commercial use. Based on their knowledge of the New York City real estate market and their extensive experience in the field of real estate development, Mr. Cremins and Mr. Kalikow determined that the Post real property was usable only for the purpose for which it was built, a publishing plant, and they placed a value of approximately $16 million on the land and building.

One element of the sale was of great importance to both parties. This involved News America's union contracts, pension liabilities and other employee benefit programs. As of September 1987, 10 unions worked with the Post under collective bargaining agreements. The unions each maintained pension and welfare plans to which News America was legally obligated to contribute. If the Post had stopped publishing, News America would have been obligated (apparently by Federal law and by the contracts) to make severance and pension payments to its unionized employees and, to some degree, to its non-union employees. According to a New York Times article published on February 25, 1988, the severance costs to the Post would have been about $40,000,000.00. Consequently, it was important to News America that the purchaser of the Post's assets continue to publish the newspaper and to assume the obligations of the Post under the union contracts. Mr. Kalikow agreed to assume those obligations; however, as a condition of purchase, he insisted on receiving significant union concessions which would save the Post $24 million in operating costs over three years. Eventually, News America and the unions negotiated a deal satisfactory to Mr. Kalikow. Mr. Murdoch was forced to contribute $3 million to reach the $24 million figure insisted upon by Mr. Kalikow. Mr. Cremins credibly testified that Mr. Kalikow would not have purchased the Post without the cost-saving agreement.

On February 5, 1988, News America and KMI executed an Asset Purchase Agreement by which News America agreed to sell all of the assets of the Post to KMI for $37,585,000.00. The purchase price of the assets sold was allocated in the contract as follows:

Machinery & equipment:	$ 4,000,000.00
Real property:	15,900,000.00
Customer accounts: 5,000,000.00	
Covenant not to compete:	10,350,000.00
Good will:	2,335,000.00

Mr. Cremins was in charge of most of the negotiations with News America, but he relied on advisers to guide him in areas with which he was not familiar. Kalikow retained the services of two law firms, Strook & Strook & Lavan and Dreyer & Traub, to represent KMI in negotiations with News America. News America was represented by its regular outside counsel, Squadron, Ellenoff, Plesent & Lehrer ("Squadron, Ellenoff"). Mr. Cremins supervised the negotiations for Kalikow, and Arthur Siskind, then chair of the Squadron, Ellenoff corporate group, oversaw News America's legal representation.

Mr. Cremins and Mr. Siskind disagreed over the amount of time involved in negotiating the allocation of the purchase price to the various assets. Mr. Cremins stated that the whole process took no more than 10 minutes, while Mr. Siskind remembered the negotiations continuing over a couple of days. Regardless of how long it took to agree to the final figures, it is clear from their testimony that both men had consulted with attorneys, accountants, investment bankers and other persons with knowledge of the nature and value of the assets before coming to an agreement on the allocations. KMI ascribed a value of $4,000,000.00 to four printing presses based on advice received from others (apparently Bear Stearns's representatives) who had examined the machinery and equipment. Other equipment was deemed to be of little value. The real property was valued based on the knowledge and experience of Kalikow and Cremins. Siskind agreed to the allocation since it was consistent with the value placed on the land and building by News America which was tied to News America's cost basis in the property of $13,900,000.00. The Tishman Appraisal was not considered by the parties in arriving at their allocation. The third item, identified as customer accounts, represented the value of certain large advertising accounts such as Macy's and The Wiz. The value of one-month's advertising revenue was used to allocate $5,000,000.00 to this asset. The most significant category from Kalikow's perspective was the covenant not to compete. Kalikow's litigating attorneys feared that Rupert Murdoch, through News America or another entity, would reenter the newspaper publishing market in the New York City area. Allocating $10,350,000.00 to the covenant would enable Kalikow to seek damages at this level if Murdoch did so. The remainder of the purchase price was allocated to good will.

Section 2 of the Asset Purchase Agreement provides, in pertinent part, as follows:

> "2.1 Purchase Price. The cash portion of the purchase price for the Assets shall be Thirty-Seven Million Five Hundred Eighty-Five Thousand ($37,585,000.00) Dollars, subject to adjustment as provided herein. In addition, Buyer shall assume certain of Seller's liabilities pursuant to Section 3 hereof."

Section 3 of the Asset Purchase Agreement, entitled Assumption of Liabilities, provides that the buyer is to assume certain enumerated obligations of the seller "to the extent that they are to be performed on or after the Closing Date". Paragraph (e) of section 3 relates to liabilities arising out of employee benefit plans. Paragraph (d) relates to employee vacation and severance pay whether or not such obligations arise under collective bargaining agreements assumed by the buyer. Paragraph (f) relates to liabilities arising out of the operation of the Post after the closing date. Paragraphs (a), (b) and (c) of section 3 provide as follows:

> "3. Assumption of Liabilities. On the Closing Date, Buyer shall agree to assume and discharge, in accordance with their terms, only the following obligations and liabilities of Seller to the extent that they are to be performed on or after the Closing Date:
>
> "(a) The liabilities of Seller as shall be set forth in the Working Capital Statement; and
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> "(b) All obligations of Seller relating to the Acquired Business under the agreements, contracts, commitments, leases, purchase contracts and sales contracts described in Schedules hereto or not required to be described therein (except as otherwise provided by Section 5 hereof) to the extent that payment or performance by Buyer under such agreements is in exchange for payment or performance to be provided to Buyer on or after the Closing Date, as the case may be, by the other party(ies) under such agreements; and
>
> "(c) All obligations of Seller relating to the Acquired Business under other agreements, contracts, commitments, leases, licenses and agreements of Seller entered into between the date hereof and the Closing Date in accordance with this Agreement, or to the extent that Buyer consents to or otherwise agrees in writing to assume such obligations at or prior to the Closing Date (except as otherwise provided by Section 5 hereof) to the extent that payment or performance by Buyer under such agreements is in exchange for payment or performance to be provided to Buyer on or before the Closing Date, as the case may be, by the other party(ies) under such agreements".

A document entitled The News Corporation Limited / Determination of Loss on the Sale of the New York Post / March 7, 1988" was entered into evidence by the Division. It was referred to as the "working capital statement". Page 3 of that document apparently relates to paragraph (a) of section 3 of the Asset Purchase Agreement. It shows that News America's working capital at the time of closing (i.e., its current assets minus its current liabilities) amounted to a loss of $6,651,723.00. Of this loss, $6,013,410.00 was included by News America in its calculation of the loss on its sale of the Post.

Mr. Cremins testified that under paragraph (a) KMI agreed to collect all monies owed to News America before the closing date and to pay all current liabilities arising out of the operation of the Post before the closing date. At the end of a certain period of time, there would be a final accounting and settlement. If assets exceeded liabilities, KMI would pay News America the excess. If liabilities exceeded assets, News America would reimburse KMI for the difference. In no case was KMI to be legally obligated to assume the debt of News America.

A dispute arose between the parties concerning the amounts due to News America under section (3) of the Asset Purchase Agreement and the side agreement relating to reduced labor costs. Apparently, the parties sued each other for breach of contract. The matter was settled by execution of an agreement of settlement dated October 25, 1988. Under the terms of that agreement, KMI agreed to pay News America $4,250,000.00 in settlement of all claims.

Section 17 of the Asset Purchase Agreement provides as follows:

> "Allocations. Buyer and Seller acknowledge that the allocations of the purchase price hereunder set forth in Exhibit 1 hereto were bargained for and negotiated, and each agrees to report the transactions consummated hereunder for Federal income tax purposes in a manner consistent with such allocations, and to file any statement required by Section 1060(b) of the Code."

Under section 8(c) of the Asset Purchase Agreement, if the gains tax on the sale of the real property exceeded $200,000.00 (for reasons other than a reduction in the seller's original purchase price) the buyer would pay the excess plus any penalties and interest due. Pursuant to section 14.1(v), the seller agreed to indemnify the buyer against "[t]he amount by which the monies paid by Seller pursuant to Section 8(c) is less than $200,000."

The sale of the Post to KMI and Peter Kalikow closed on March 7, 1988. News America and KMI timely filed the required real property transfer gains tax questionnaires reporting gross consideration for the transfer of the real property of $15,900,000.00. The original purchase price was claimed to be $14,199,246.28 yielding a gain subject to tax of $1,700,753.72. News America paid gains tax of $170,075.37. A copy of the Asset Purchase Agreement was forwarded to the Division of Taxation ("Division") with the questionnaires. A field audit was conducted by the Division in 1991.

The auditor did not testify concerning the audit method or results, but his reports were offered in evidence. The auditor made some adjustments to both the original purchase price claimed by News America and the amount of consideration reported.

In a narrative report, the auditor states that News America provided adequate records and documentation to substantiate the amount of the original purchase price claimed by the transferor. The auditor disallowed $219,911.00 of the original purchase price attributable to acquisition of the real property, stating in his report that the disallowance represents the difference between the amount shown in News America's general ledger and the amount claimed at the time of the transfer. News America claimed total capital improvements of $5,492,502.79. This represents $4,089,478.11 in costs claimed in News America's initial filing and an additional $1,403,024.79 claimed during the audit. The auditor disallowed $417,547.00 of the claimed total resulting in audited capital improvement expenses of $5,074,956.00. Original purchase price (as shown on a worksheet entitled Calculation of Acquisition -- Capital Improvement Cooping Costs) was determined to be $14,964,813.00.

The major area of dispute that arose during the field audit concerned the amount of consideration paid for the real property. The auditor determined that the total amount of consideration paid by KMI for all of the Post's assets exceeded the cash price of $37,585,000.00 recited in the Asset Purchase Agreement. According to the auditor's handwritten notes, the Division concluded that KMI had assumed certain liabilities in connection with its purchase of the Post but was unable to determine the nature or extent of the obligations. The auditor's notes state "it appears that the major obligations related to vacation, dismissal and severance pay costs that would be incurred by the buyer if the paper (NY Post) closed operations subsequent to the acquisition closing date. . . ." At the close of the audit, the amount of consideration for the entire transaction was found by the Division to be "undeterminable".

The auditor asked News America to submit a written explanation of the method used by News America and Kalikow to apportion the cash purchase price to the real property in order for the Division to make a determination regarding the reasonableness of that apportionment. A written explanation was not submitted.

On March 28, 1991, the auditor conducted a search of the Manhattan County Records Department and discovered that a mortgage for $25,000,000.00 had been recorded against the real property on June 14, 1988, approximately 2½ months after the closing occurred. The mortgagee in this transaction was Banker's Trust Company. The auditor requested that News

America provide the Division with a copy of the appraisal submitted to Banker's Trust. In response, the Division was given a copy of the Tishman Appraisal.

On May 3, 1991, a meeting was held which was attended by representatives of the Division, News America and KMI. At this meeting, News America and KMI explained the method used to apportion the consideration to the real property. Primarily, it was claimed that the apportionment was the result of arm's length bargaining between a willing buyer and seller. KMI's representative stated that the Banker's Trust mortgage was not indicative of the fair market value of the real property since Mr. Kalikow also had to give his personal guaranty for the loan. News America also pointed out that the amount of $15,900,000.00 for the real property was reported for Federal income tax purposes by both parties. Finally, News America and KMI claimed that the amounts allocated to the covenant not to compete and to good will were reasonable.

The Division determined that the apportionment of the purchase price to the real property was not reasonable. This determination rested on several grounds. First, the Division noted that when News America acquired the Post in 1976 the real property was valued at $10,000,000.00. News America made capital improvements totalling over $5,500,000.00. Thus, its total investment in the real property amounted to $15,500,000.00. The Division considered it unreasonable to value the property at an amount that allowed so little for capital appreciation. Also, the Division concluded that total consideration included the assumption of liabilities and, therefore, the claimed consideration of $37,585,000.00 was only a portion of the total. Finally, the auditor concluded that News America had not demonstrated that "a reasonable method of apportionment was used in allocating the total consideration" (auditor's workpapers, schedule A).

After concluding that the parties' allocation was not reasonable, the Division determined that the fair market value of the property was $35.5 million, based on the Tishman Appraisal. The Division increased consideration for the real property by $19,600,000.00. Based on KMI's agreement to indemnify News America for any amount of gains tax exceeding $200,000 the

Division then increased consideration by $2,059,466.00. As a result of the audit, the gain subject to tax was increased from $1,700,753.72 to $20,535,187.00, with a tax due of $2,053,519.00. Applying the equation found in section 590.9 of the gains tax regulations, the auditor calculated gains tax to be paid of $2,259,466.00. Tax paid by News America was subtracted from the audited tax due to compute a balance due of $2,089,391.00.

The Division issued to News America a Notice of Determination dated December 2, 1991 assessing gains tax of $2,089,391.00 plus penalty and interest.

At the time of the closing on the Post property, News America and KMI modified the gains tax indemnification provision by reducing the amount to be paid by News America to $170,075.37 (the amount actually paid at the time of transfer). KMI was then obliged to pay any amount of gains tax due over and above that amount.

In connection with the sale of the real property, Mr. Kalikow's attorneys, Dreyer & Traub, obtained title insurance from Ticor Title Guarantee Company in the amount of $15,900,000.00. Title to the real property was held by Mr. Kalikow in his personal capacity and not by KMI.

To obtain working capital for the operation of the Post and to finance the purchase, Peter Kalikow obtained over $80,000,000.00 in loans from Banker's Trust. Paul V. Reagan who was then vice-president and counsel in the Banker's Trust legal department explained the circumstances surrounding the bank's decision to extend credit to Kalikow. Mr. Reagan was generally responsible for supervising loans including the loans made to KMI and Kalikow.

Mr. Reagan confirmed Mr. Cremins's testimony that during the mid-eighties banks were competing with each other to provide credit to the real estate markets. In this case, Banker's Trust approached Mr. Kalikow with an offer to provide credit for the acquisition of the Post. The first proposal structured by the bank's loan officers was not approved by Banker's Trust. Mr. Reagan thought this explained the fact that the financing was not completed until after KMI had closed on the sale.

A loan proposal memorandum prepared by Banker's Trust's loan officers describes some of the salient conditions of the loans and lines of credit extended to KMI and Kalikow. Each loan package is referred to in the memorandum as a "facility". Three facilities were approved. According to the memorandum, "[t]he purpose of the facilities is to finance Peter S. Kalikow's acquisition of the New York Post from Rupert Murdock (sic)".

Facility 1 was an unsecured line of credit in the amount of $35,000,000.00 extended to Peter S. Kalikow personally. Facility 2 consisted of four letters of credit in the following amounts and with the following expiration dates:

#1 $ 7,239,375.00 Projected Expiry 3/7/89
#2 $ 7,776,000.00 Projected Expiry 3/7/90
#3 $ 8,378,100.00 Projected Expiry 3/7/91
#4 $ 8,991,000.00 Projected Expiry 3/7/92

The purpose of the four letters of credit, is explained in the memorandum as follows:

> "Kalikow is acquiring The New York Post for $37.585MM. BTCo. provided a $37.585MM L/C to secure the purchase price for the contract of sale on February 15, 1988. At closing (3/7/88), Kalikow will return the $37.585MM to BTCo., pay $10.585MM in cash and sign a note to the seller for the remainder of the purchase price ($27MM) which is due and payable in 4 equal installments of $6.75MM over the next 4 years. The note bears an interest rate of floating prime. As such, the note and an assumed interest rate are secured by 4 L/C's as referenced above. The principal amount and the assumed interest rate total $32.4MM. . . . As each installment is paid, the L/C's will be returned."

The third facility was described as a term loan to Peter S. Kalikow in the amount of $25,000,000.00. The collateral for the loan was a first fee mortgage on the Post real property. In addition, the bank received a personal guaranty from Kalikow. The memorandum states: "To the extent that the appraised value of 210 South Street does not support the $25,000,000 loan on a 75% Loan to Value basis, Peter Kalikow will provide a principal guarantee of the difference." In evaluating the risk associated with this loan, the memorandum states:

> "With respect to the mortgage on 210 South Street, to the extent that BTCo.'s due diligence process reveals that the property is unable to support a $25MM Loan at a 75% Loan to Value, the difference in the appraisal value and the requested loan amount will fall under Peter S. Kalikow's personal guarantee.

By letter dated March 8, 1988, a loan officer informed Mr. Kalikow that Banker's Trust had approved a term loan to him in the amount of $25,000,000.00. That letter provides, in pertinent part:

> "You shall have the right to request more than one disbursement of the Loan, so long as the aggregate total of all advances shall not exceed $25,000,000.00 and the conditions set forth herein for closing shall be satisfied with respect to such advance. In such case, the note and mortgage amount may be changed to reflect the amounts of the advance. . . . The Loan shall be non-recourse, except that you shall guaranty payment of interest on the Note and the portion of the Loan outstanding as shall exceed 75% of the appraised value of the Premises as shown on the appraisal utilized by the Lender to satisfy the requirement in paragraph 1(a) in the annexed General Conditions."

As a condition of the $25 million loan, Mr. Kalikow was required to provide Banker's Trust with an appraisal and did provide a copy of the Tishman Appraisal. Banker's Trust also received Mr. Kalikow's personal guaranty and a first mortgage on the Post real property. The mortgage was executed on June 14, 1988 and recorded on June 21, 1988. On the date of execution, Mr. Kalikow executed a personal guaranty. Ticor Title Insurance Company issued to Banker's Trust title insurance on the real property in the sum of $25,000,000.00 as of June 14, 1988.

Mr. Reagan testified that it was Banker's Trust's belief, based on the Tishman Appraisal, that the loan to Mr. Kalikow in the amount of $25 million was secured by the Post real property. He also testified that the appraisal was a significant factor in the Post's decision to approve the loans to Kalikow. Under cross-examination Mr. Reagan was asked why Banker's Trust accepted the Tishman Appraisal rather than doing its own appraisal or causing an appraisal to be done for the specific purpose of determining the value of the real property as collateral for the loan. He replied that in his experience the reason was probably the expense involved in obtaining an appraisal, but he went on to state:

> "I think given [Kalikow's] net worth, given the desire of the bank to establish a substantial relationship with him, they would have been quick to agree to use the William White appraisal. I've seen it before. Subsequent to 1990, I don't believe we'd do it again." (Tr., p. 169.)

Mr. Reagan also testified that in his opinion use of the Tishman Appraisal to approve the loan "was a mistake" (tr., p. 169), and said he that he found it incredulous that the property was appraised at $35.5 million in 1987.

At sometime after KMI's purchase of the Post, Peter Kalikow and Kalikow Real Estate Company commenced bankruptcy proceedings. A consolidated Chapter 11 Plan of

Reorganization was filed in the United States Bankruptcy Court, Southern District of New York, on December 23, 1993. Eventually, Kalikow put the Post up for sale.

In 1991, Banker's Trust engaged Cushman & Wakefield, Inc., an appraisal service, to estimate the market value of the Post building as encumbered by a proposed lease to the New York Post. This appraisal was sought in connection with the bankruptcy proceedings of Peter Kalikow and Kalikow Real Estate Company. Cushman & Wakefield found that the market value of the real property (encumbered by the proposed lease) was $14 million as of September 1991. Cushman & Wakefield evaluated the highest and best use of the property in its condition as a newspaper printing plant and if vacant, to be held for future residential redevelopment. The Cushman & Wakefield Appraisal contains the following definition of highest and best use as defined in the Dictionary of Real Estate Appraisal, Second Edition (1989):

"1. The reasonable and probable use that supports the highest present value of vacant land or improved property, as defined, as of the date of the appraisal.

"2. The reasonably probable and legal use of land or sites as though vacant, found to be physically possible, appropriately supported, financially feasible, and that results in the highest present land value.

"3. The most profitable use."

Cushman & Wakefield came to the following conclusions concerning the highest and best use of the Post real property.

> "In the course of our investigation, we determined that current market conditions do not warrant the re-development of the site. It is our opinion that the subject improvements should be used on an interim basis as, minimally, a light manufacturing building with an appropriate office component. The most efficient and truly highest and best use of the facility would be the continued utilization for newspaper publication. The latter utilization would maximize the office space finish and central printing press core of the subject. Further, it is our opinion that, after the interim use tenancy expires in an approximate 10 year period, the market conditions will warrant the re-utilization, or redevelopment, of the site into a residential application. Therefore, on an as-improved basis, it is our opinion that the subject improvements should be utilized to generate income on an interim use basis. Following this interim use period, the subject will be suitable for redevelopment into a residential use." (Cushman and Wakefield Appraisal, pp. 38-39).

In evaluating the market value of the property, Cushman and Wakefield concluded that rezoning of the property from light manufacturing to residential use was possible.

In February 1993, a corporation owned by Stephen Hoffenberg offered to purchase the

Post real property for $15 million. Since Banker's Trust was a secured creditor of the property, its agreement to accept the offer was required, and it did agree. However, the final sale to Mr. Hoffenberg was never consummated.

In 1993, Mr. Reagan, on behalf of Banker's Trust, took part in negotiations for the lease of the Post real property to News America. Such a lease was executed between Peter S. Kalikow, as debtor and debtor-in-possession of the real property, and NYP Holdings, Inc. (apparently, a News America subsidiary or affiliate corporation) on October 1, 1993. The lease contains an option to purchase the real property at a price that varies depending on when the option is exercised. The option prices are from $7 million in the first year of the lease to $12.5 million in the fifth year of the lease. News America now operates the New York Post under a management agreement.

At about the time News America entered into the management agreement to operate the New York Post, it requested an appraisal of the real property from Edward S. Gordon Company, Inc. The report provided to News America consists of a three-page letter, dated April 2, 1993, in which the Gordon Company summarized its findings (hereinafter the "Gordon Report"). The Gordon Report concluded that the highest and best use for the site would be its continued use as a printing facility. The Gordon Report also states that the probability of finding a user, or tenant, for the property was very low. The Gordon Report did not estimate the fair market value of the real property.

Mr. Siskind testified that at the time the management agreement was entered into News America was making an application for waiver of the FCC cross-ownership rules in order to buy the Post. The Gordon Report was requested to help News America determine whether it wanted to purchase the Post, whether it should continue publishing in the Post building and how it should frame its purchase offer.

Attorneys for News America engaged Valuation Research Corporation ("VRC") to review the allocation of the purchase price of the Post as set forth in the Asset Purchase Agreement and to render an opinion as to its reasonableness. VRC undertook an investigation and appraisal of the fixed and intangible assets of the Post for the purpose of expressing an opinion of their fair market value as of March 3, 1988.

According to the VRC Report, consideration was given to the March 6, 1988 deadline set by the FCC for News America's compliance with the cross-ownership regulations. VRC's investigation led it to conclude that the fair market value range of the appraised fixed and intangible assets of the Post, as of March 3, 1988, was as follows:

	Fair Market Value Range
Fixed Assets	
Land and Buildings	$15,600,000.00 - $15,950,000.00
Machinery and Equipment	$7,032,000.00
Intangible Assets	
Advertising List	$ 3,100,000.00 - 3,300,000.00
Masthead	1,700,000.00 - 2,500,000.00
News Library	1,000,000.00 - 1,500,000.00
Non-compete Agreement	8,200,000.00 - 11,700,000.00

Based on these fair market values, VRC gave its opinion that the allocations by asset category in the Asset Purchase Agreement were not unreasonable.

The appraisal of the real property was completed by Daniel T. Vigano, a vice-president of VRC and a Member of the Appraisal Institute. Many of Mr. Vigano's observations echoed statements made by Mr. Cremins and in the Cushman & Wakefield Appraisal. The building is described as being in an isolated location somewhat cut off from the neighborhoods in its immediate vicinity (Chinatown, the financial district, the City Hall area) by a ring of high-rise apartment buildings. Public transportation is described as available but not readily accessible; however it is stated that there is ready access to the FDR Drive, the Battery Tunnel and the Brooklyn and Manhattan Bridges for vehicular travel.

Mr. Vigano concluded that the highest and best use of the property, and as improved, is the current use as an industrial or manufacturing building. With this assumption, Mr. Vigano appraised the value of the real property using two methods, the cost approach and the sales comparison approach.

The cost approach requires a determination of the fair market value of the land and an estimate of reproducing the capital improvements and then deducting for depreciation. Mr. Vigano considered the cost approach to be a reliable method for estimating the market value of an older building like the Post's. The cost approach indicated a market land value of $12,400,000.00 and a depreciated improvement value of $3,157,183.00. This resulted in an overall appraisal of $15,600,000.00.

The sales comparison approach is what the name suggests, an estimate of market value based on sales of similar properties within a similar period of time (described in the Tishman Appraisal as the Market Approach). The three sales selected by Mr. Vigano for comparison purposes occurred between May 1985 and May 1987. The buildings were all commercial properties suitable for light industrial use. Adjustments were made by Mr. Vigano to account for the different sizes of the three buildings (only one was as large as the Post building). The overall value of the Post building using the sales comparison approach was $60.00 per square foot or $15,933,300.00.

The Division presented the testimony of V. Vincent Lee, a qualified appraiser of real property, to support its contention that the Tishman Appraisal contains a reasonable estimate of the fair market value of the Post real property at the time of the transfer from News America to Peter Kalikow. In his testimony, Mr. Lee focused primarily on the Market/Sales Comparison Approach used in the Tishman Appraisal. Using that approach, the Tishman Appraisal determined a market value for the real property of $34,400,000.00 ($41,300,000.00 if converted to residential use). The VRC Appraisal determined a market value of $15,933,000.00 using a sales comparison approach. In both cases the estimate of fair market value was based on a price of approximately $50.00 to $60.00 per square foot. Mr. Lee pointed out that the difference is due to the fact that the Tishman Appraisal valued the property as if vacant land and assumed the demolition of the existing building and the use of the entire site for a new building while the VRC Appraisal assumed the rental of the existing building.

Mr. Lee made the point that the real property on which the Post building is located is an extremely unsual site for the City of New York because of its size. Although the existing building has 265,555 square feet of floor space it is located on a land area of 68,867 square feet which would allow a building with a FAR of 830,000 square feet to be built on the land. Mr. Lee considered it reasonable to value the property as vacant land and to build to the maximum FAR.

Mr. Lee also testified that the determination of highest and best use for the property is critical to the appraisal, since different assumptions will yield very different results. Mr. Vigano concluded that the highest best use for the Post building in 1988 was as a light industrial or manufacturing building and for comparison purposes used loft buildings used for those purposes. The Tishman Appraisal concluded that the highest and best use would be to redevelop the property for a residential use, or, alternatively, as a commercial building and for its comparisons used loft buildings converted to commercial office space.

Mr. Lee testified that in 1987 the New York real estate market was in a "speculative bubble" and, as he put it, investors like Kalikow "built up fortunes of tens or hundreds of millions of dollars converting things to other things. . ." (tr., p. 316). In light of the market conditions existing in 1987 and 1988, Mr. Lee considered the Tishman Appraisal, especially its highest and best use analysis, to be reasonable. In fact, he found it extremely thorough, reliable and consistent with professional standards of appraisal. Mr. Lee considered the VRC Appraisal of the real property to be unreasonable because in his opinion it did not adequately address the available building area and assumed a highest and best use as an industrial or light manufacturing building. He also expressed his discomfort with the VRC report, falling just short of stating that Mr. Vigano lacked independence.

Mr. Lee did not offer an analysis of the comparable sales used in the Market Approach segment of the Tishman Appraisal. He did dispute Mr. Cremins's statements regarding the condition of the neighborhood immediately around the Post. He testified that the neighborhood is a stable area of mixed use, not unusually crime ridden or worn for lower Manhattan. As a consequence, he did not believe that the Post property was unsuitable for commercial office development.

The Tishman Appraisal determined a value of $30,700,000.00 using an income approach. Mr. Vigano did not use the income approach in his valuation because the property did not generate income which he believed made it impossible to determine income expectancy for the building. Mr. Lee did not review the income approach as used in the two appraisals.

Mr. Vigano testified that developing the Post real property to its maximum FAR would be unrealistic and speculative. Based on data showing an excess of office space in Manhatten even before the stock market crash of October 1987 (including the Tishman Appraisal), Mr. Vigano stated his opinion that it was inconceivable that a real estate developer would have undertaken development of such a massive office building at the time the Post was sold to Mr. Kalikow.

SUMMARY THE OF PARTIES' POSITIONS

Petitioner contends that the apportionment of the consideration to the real property in the Asset Purchase Agreement (hereinafter the "apportionment agreement") resulted from arm's length negotiations between buyer and seller and, consequently, is a "reasonable apportionment" as that term is defined in Tax Law § 1440(1)(c). In addition, petitioner claims that other evidence in the record supports the reasonableness of the apportionment agreement, including the VRC Appraisal, the Cushman & Wakefield Appraisal, and the Hoffenberg purchase offer. Petitioner states that where an apportionment agreement is the result of arm's length bargaining between buyer and seller the burden of proof is on the party challenging the reasonableness of the apportionment. It then claims that the Division has failed to show that the apportionment agreement was unreasonable. Petitioner argues that the Division's fair market valuation of $35.5 million is illogical since it results in apportioning almost the entire consideration to the real property and attributes little value to the other assets sold. Petitioner disputes the Division's claim that KMI's assumption of contingent pension and severance liabilities is additional consideration to petitioner. Petitioner dismisses the Tishman Appraisal as a selling tool intended to entice prospective buyers. In his opening statement, petitioner's representative referred to it as a "puff piece". Petitioner claims that the Tishman Appraisal is irrelevant for gains tax purposes. Petitioner argues that the Banker's Trust mortgage of $25 million is no measure of the real property's value since Kalikow also gave his personal guaranty for the loan. Petitioner contends that the Division erred in treating Kalikow's agreement to pay gains tax over an agreed upon amount as additional consideration. For the first time in its brief, petitioner claims additional selling expenses of $743,000.00 which represents the fee paid to Allen & Co. for preparing the offering memorandum. Finally, petitioner argues that if any gains tax is due penalties should be cancelled since petitioner followed the gains tax regulations and consistently adhered to its apportionment agreement for all purposes, including the gains tax law.

The Division states that petitioner has the burden of demonstrating that there was a reasonable apportionment and that the fair market value of the real property is consistent with the apportionment agreement. The Division claims that petitioner failed to carry its burden of proof. It is the Division's position that the apportionment agreement was "a thinly veiled attempt by the parties to circumvent the gains tax law" (Division's brief, p. 8). According to the Division the unreasonableness of the apportionment is demonstrated by the fact that the apportionment failed to take into account the Tishman Appraisal. Premised on the assumption that the fair market value of the property was $35.5 million, the Division argues that the parties assigned a suspiciously low value to the real property and inordinately high values to other assets. The Division contends that the apportionment violates the "residual method of allocation" required by the Federal income tax law. The Division finds that "the most compelling factor which dooms the reasonableness of the entire allocation is that it was not performed at arm's length" (Division's brief, p. 10). According to the Division, petitioner and KMI benefitted from an agreement to set a low value on the real property: petitioner's gains tax liability was reduced and, since KMI agreed to indemnify petitioner for any liability above $200,000.00, it likewise benefitted from the arrangement. Moreover, the Division argues, "[b]y allocating a minimum amount to the real estate, which had a 37.5 year depreciable basis, it was able to shift a large part of the consideration to the assets with short depreciation/amortization schedules" (Division's brief, p. 10). The Division challenges the allocation of over $10 million to the covenant not to compete on the ground that it was unnecessary since petitioner and its affiliates were prohibited from owning a newspaper in the metropolitan New York City area by the FCC regulations. Under these circumstances, the Division claims, the allocation had no basis in economic reality. Based on the testimony of Mr. Lee, the Division argues that the VRC Appraisal is unreasonable.

The Division claims that its determination of fair market value is correct. It is the Division's position that the total consideration for all assets was greater than $37,585,000.00. The Division points to the settlement of the contract dispute between petitioner and Kalikow as evidence that KMI assumed obligations of petitioner in the amount of $4,250,000.00. The gains tax indemnification agreement is pointed to as further evidence that consideration exceeded the amount recited in the apportionment agreement. Finally, the Division claims that Kalikow assumed a huge contingent liability for unfunded pension plans and that this liability must be considered in determining the reasonableness of the apportionment. The Division relies on the Tishman Appraisal as evidence of the fair market value of the real property, noting that (1) its expert witness found its conclusions to be reasonable, (2) Banker's Trust relied on it in granting Kalikow a $25 million loan and (3) petitioner used it to market the Post. Finally, the Division asserts that petitioner has failed to establish that it is entitled to abatement or cancellation of penalties.

CONCLUSIONS OF LAW

A. Section 1441(1) imposes a tax of ten percent on the gain derived from the transfer of real property in New York State. The gain is the difference between the consideration for the transfer of real property and the original purchase price of such property (Tax Law § 1440[3]). "Consideration" is defined, in relevant part, as "the price paid or required to be paid for real property or any interest therein" (Tax Law § 1440[1][a]). This definition of consideration is elaborated upon in Tax Law § 1440(1)(c) which provides:

> "In the case of a transfer which includes other assets which are in addition to real property or an interest therein and for which there is no reasonable

apportionment of the consideration for such real property or interest, consideration means that portion of the total consideration which represents the fair market value of such real property or interest."

Under the statutory definition, resort to fair market value analysis is appropriate only in those cases where no reasonable apportionment of the consideration for the real property has been made (Matter of Beekman Country Club v. Wetzler, 199 AD2d 640, 604 NYS2d 989; Matter of Bridgehampton Investors Corp., Tax Appeals Tribunal, August 11, 1988). Accordingly, where apportionment of the consideration is an issue raised by either party, the first inquiry is whether there is a reasonable apportionment. Petitioner claims that where an apportionment exists the burden of proof is on the party attacking it. The Division states that petitioner bears the burden of proof on every issue. In this case, questions relating to the allocation of the burden of proof cannot be determined until a standard for judging the reasonableness of the apportionment is established.[2] In two decisions, the Tax Appeals Tribunal has discussed such a standard.

In Matter of Shareholders of Beekman Country Club (Tax Appeals Tribunal, April 16, 1992, confirmed sub nom Matter of Beekman Country Club v. Wetzler, 199 AD2d 640, 604 NYS2d 989), the Tribunal found that an apportionment agreed to by a buyer and seller, each of which is freely negotiating in his or her own best interests, is a reasonable apportionment for purposes of the statute. The Tribunal stated that this method of judging the reasonableness of an apportionment is consistent with its

definition of fair market value as "the price at which a willing seller and a willing buyer will trade" (Matter of Shareholders of Beekman Country Club, supra, quoting Matter of

[2]The Division states in its brief that if the parties "present an apportionment to the real property which is found by the Department not to be reasonable, the consideration, by statute, must be deemed to be the portion of the total consideration which equals the fair market value of the real property" (Division's brief, p. 5). This theory offers no standard for evaluating the reasonableness of the apportionment (i.e., for determining when a petitioner has satisfied the burden of proof). It merely allows the Division to shift the inquiry from the reasonablness of the apportionment to the fair market value of the property as it chooses. There is no authority for this policy.

Bridghampton Investors Corp., supra). Moreover, the Tribunal has refused to consider appraisals of fair market value which would vary the terms of the apportionment agreement, until the party challenging the agreement first established the unreasonableness of the apportionment (see, Matter of Shareholders of Beekman Country Club, supra; Matter of Bridgehampton Investors, supra). In short, a contractual agreement is, in and of itself, prima facie evidence of a reasonable apportionment, and, in the face of such an agreement, the burden of proof is on the party challenging the apportionment.

B. Judged against the standard established in Beekman, there can be no question that petitioner carried its burden of establishing the existence of a reasonable apportionment of the consideration to the real property and that the burden then shifted to the Division to show that the apportionment was not reasonable.

There is substantial evidence in the record that the apportionment agreement resulted from arm's length negotiations. The agreement was bargained for by the parties and contractually binding on both of them. The principals of each corporation were seasoned and successful businessmen, and each was represented by astute and experienced negotiators. Moreover, the primary representatives of the parties (Mr. Cremins and Mr. Siskind) consulted with attorneys and other professionals to aid them in negotiating the terms of the contract. Mr. Cremins testified that he engaged the services of Mickey Tarnepoll, a senior managing partner at Bear Stearns, to evaluate the Allen & Co. memorandum. Mr. Cremins and Mr. Kalikow were knowledgeable real estate developers capable of determining the value of the Post real property. Mr. Cremins credibly testified that they determined that the property's value was less than $16 million. Mr. Cremins testified that the apportionment negotiations took only 10 minutes while Mr. Siskind remembered them continuing over two days. Regardless of how quickly the final resolution was reached, the evidence shows that both men were fully apprised of all relevant considerations when they entered into those negotiations. Negotiations need not be rancorous or protracted to be considered at arm's length.

C. The reasonableness of the apportionment of the purchase price to the real property is supported by evidence independent of the apportionment agreement. It must be remembered that the real property was one asset belonging to News America. What was bargained for and what was sold was a newspaper business. The Allen & Co. offering memorandum demonstrates that what News America was selling was a newspaper business. Although it refers to the Tishman Appraisal, the memorandum never markets the real property for conversion to another use. There is no evidence whatsoever that Peter Kalikow ever intended to use the real property for any purpose other than as a publishing and distribution plant for the New York Post. Moreover, the evidence shows that all other potential buyers intended to use the real property as a newspaper printing plant. It was reasonable for the parties to affix a price for the real property based upon its intended use, and every fair market value appraisal of the Post real property as a newspaper printing plant is consistent with the value assigned to the property in the apportionment agreement. The 1991 Cushman & Wakefield Appraisal and the VRC Report concluded that the value of the property as a newspaper plant was less than $16 million. The Gordon Report found that the property had no value except as a newspaper printing plant.

Accordingly, I find that News America has established that the apportionment agreement is a reasonable apportionment of the consideration to the real property. The grounds advanced by the Division for denying the reasonableness of the apportionment are not persuasive.

D. The Division's claim that the transferor's and transferee's apportionment is not reasonable rests primarily on the fair market value of the real property as determined by the Tishman Appraisal. For the following reasons, I find the Tishman Appraisal to be irrelevant to determining whether the apportionment is reasonable.

First, the Tishman Appraisal is not evidence of what was bargained for and sold: a newspaper printing plant. The Tishman Appraisal valuations are largely premised on the assumption that the highest and best use of the property would be to redevelop it for a residential use or, in the alternative, for commercial use. For the Market Approach, the Tishman Appraisal compared the Post building with loft buildings which were intended to be converted, or were converted, to commercial office space. For the Market/Sales Comparison Approach, the Tishman Appraisal valued the property as if vacant land and assumed the building of a commercial office building or residential building at the maximum FAR allowable for the site. For the Income Approach, the Tishman Appraisal valued the real property as rented office space.[3] There is no evidence that any buyer was willing to purchase the real property to develop it for commercial or residential use. In fact, the opposite is true. The Post real property was marketed and purchased in connection with the sale of the Post as an ongoing newspaper business. All potential buyers approached the sale as the purchase of a newspaper business. The real property was sold for and purchased as a newspaper printing plant. The Tishman Appraisal did not attempt to assess the value of the real property as a newspaper printing plant; therefore, its results are irrelevant to show the price at which a willing seller and willing buyer would trade.

Although the Tishman Appraisal was used as a selling tool, there is evidence in the record from which it can be inferred that News America was not willing to sell the real property except as part of the sale of the newspaper. As evidenced by the Allen & Co. memorandum, the Post was marketed as a newspaper business. There is little in the Allen & Co memorandum to suggest that News America intended to sell off the Post's assets piecemeal. Moreover, because of its contractual and statutory obligations to its union members, News America's costs of shutting down the newspaper would have been approximately $40 million, more than the value of the real property as determined by the Tishman Appraisal. Therefore, it could have little financial incentive to sell the property for development as a commercial or residential property. These facts also suggest the irrelevance of the Tishman Appraisal.

Inasmuch as the Division bases most of its arguments on the Tishman Appraisal and its

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[3]Mr. Lee testified that he gave little consideration to this approach, and Mr. Vigano testified that such an approach was untenable. Apparently, no one gave any consideration to using the building in this manner. Based on the testimony, I conclude that the income approach is not a reliable method for determining the value of the property.

$35 million valuation, those arguments are without merit.

E. The Division contends that News America and Kalikow "improperly ignored the Tishman Appraisal" and cites to 20 NYCRR former 590.47(b) (renum as 20 NYCRR 590.48[b], eff November 9, 1994) as support for the contention that the parties' failure to allocate a value to the Post real property consistent with the Tishman Appraisal is evidence of the unreasonableness of the apportionment. I have found that the Tishman Appraisal is irrelevant because it does not address the value of the real property as a newspaper printing plant; therefore, I do not find that News America and KMI acted unreasonably when they ignored the appraisal. Moreover, in Matter of Beekman Country Club v. Wetzler (supra), the court had this to say about the regulation:

> "The language of 20 NYCRR 590.47 is by no means clear, but the examples set forth therein suggest that the provision is intended to apply to the apportionment of the controlling interest [of an entity with an interest in real property] and not to the apportionment, as in this case, of the real property and the assets not constituting real property (cf., 20 NYCRR 590.11). In any event, although 20 NYCRR 590.47 indicates that fair market value is generally determined by appraisal, we perceive no intention to require the use of an appraisal in all cases." (Matter of Beekman v. Wetzler, supra, 604 NYS2d at 990; emphasis in original).

Apparently, the Division finds it significant that the Tishman Appraisal was prepared before the apportionment agreement was entered into and was accepted by petitioner as a selling tool. I cannot agree that these facts show that the Tishman Appraisal was entitled to great weight in the parties' negotiations. Again, an apportionment agreement entered into by a willing buyer and willing seller is a reasonable apportionment under Beekman. There is no evidence that a buyer ever came forward to purchase the real property, separately from the Post, or offered $35 million for the real property. The only willing buyer was Peter Kalikow, and there is no evidence that he was willing to pay $35 million for the Post real property. In effect, the apportionment agreement indicated what Kalikow was willing to pay for the real property, and it satisfied the apportionment requirement of Tax Law § 1440(1)(c); therefore, the Tishman Appraisal (without more) is not a basis for finding that the apportionment is unreasonable.

The Division states that ignoring the Tishman Appraisal was inconsistent with News America's practice of relying on other appraisals, including the the Coats & Burchard appraisal of 1977 and the Gordon Report of 1993. I do not agree. The 1977 Coats & Burchard appraisal valued the real property at approximately $10 million and the Gordon Report contained no valuation but found that the property had no value except as a printing plant. Perhaps, News America ignored the Tishman Appraisal because it found it to be overly optimistic in its valuations.

F. The Division's contention that the apportionment agreement did not result from arm's length negotiations is rejected. The Division puts forth a fairly speculative scenario to support its argument. According to the Division, the purpose of the apportionment was to avoid gains tax. As the Division notes, the lower the consideration apportioned to the real property, the lower the gains tax liability to the seller. Presumably, most buyers would have an interest in apportioning the largest amount they could negotiate to the real property since this would result in a higher original purchase price (and less gain) when the buyer sells. According to the Division, this scenario results in an arm's length tension which brings about a reasonable apportionment. In this case, the Division argues, the tension was broken by the gains tax indemnification agreement which placed the liability for any additional gains tax determined to be due on the buyer, Peter Kalikow. As a result of the agreement, says the Division, it was to petitioner's and Kalikow's benefit to shift the consideration from the real property to other assets, keeping the gains tax liability low.

The Division argues that the Beekman standard for judging reasonableness of an apportionment does not apply in this case because of the existence of the indemnification agreement and the lack of arm's length negotiation which allegedly results from it. However, the scenario devised by the Division is not so different from the facts that existed in Beekman. There, the petitioner was a corporation which operated a golf course. It sold 100% of the shares of stock to a transferee for $6,429,955.09 and the promise to satisfy an existing first mortgage on the premises in the amount of $370,000.00. In a separate agreement, the parties apportioned $6,390,955.09 of the consideration to the real property. The Tribunal found as a fact that the sole purpose of the allocation agreement was to provide an allocation of the consideration for purposes of the gains tax law; nonetheless, the agreement was held to be an arm's length bargain, and the petitoner was held to be bound by the terms of that agreement. There was less evidence in Beekman of prolonged or adversarial negotiation than there is here; yet, the Division argued, and the Tribunal agreed, that the allocation agreement was a reasonable apportionment (Matter of Shareholders of Beekman Country Club (supra).

In negotiating the apportionment, KMI had the same incentive that might motivate any other buyer -- a greater consideration results in a higher original purchase price and a lower amount of gain when the property is resold (and a higher cost basis from which to calculate capital gain for income tax purposes). In any case, the decision in Beekman discourages speculation into the motives of the seller and buyer by deeming a legally binding contract between the parties to be a reasonable apportionment in the absence of other evidence that the agreement is not reasonable.

G. The Division states that the apportionment violated proper allocation methods. This argument rests on the dubious premise that the actual value of the real property was $35 million. It is only with this assumption in place that the Division can state that the parties valued the real property at less than 45% of its known value in order to "circumvent the gains tax law" (Petitioner's brief, p. 8). The Division uses the Tishman Appraisal as proof that the real property was actually worth $35.5 million and then uses the parties' failure to accept the Tishman Appraisal as proof that their apportionment violated established apportionment principles. Other claims made by the Division (that the apportionment was "suspiciously odd" [Division's brief, p. 9] and "indicative of some other ulterior motive" [Division's brief, p. 7) are also premised on the assumption that the real property had a fair market value of $35.5 million. The only basis for that assumption is the Tishman Appraisal which has already been rejected as irrelevant. An appraiser may be bound by professional standards to determine the fair market value of a property based upon its highest and best (i.e., most profitable) use. But the gains tax law does not obligate a buyer to put a piece of property to its highest and best use.

The Division argues that the allocation agreed to by the parties violated "the residual method of allocation which was clearly intended by the parties" (Division's brief, p. 9). Whether the apportionment satisifed Federal income tax provisions is not relevant for determining the reasonableness of the apportionment (see, Matter of V & V Properties, Tax Appeals Tribunal, July 16, 1992; Matter of SKS Assoc., Tax Appeals Tribunal, September 12, 1991). In any case, the Division's argument rests on the premise that the parties failed to allocate "one hundred percent of known fair market value to each of the assets (Division's brief, p. 9). Again, that statement is only true if one assumes that the fair market value of the real property was greater than the amount allocated to it by the parties.

H. The Division claims that the covenant not to compete has no basis in economic reality. According to the Division, Kalikow's fear that News America would seek to reenter the newspaper market was highly questionable, and it points to Mr. Cremins's statement that the apportionment negotiations took little time as proof that there was no legitimate basis for the amount allocated to the covenant. In fact, Mr. Cremins testified that KMI's fear of future competition from News America was a serious concern and that Kalikow was advised by his attorneys to allocate as much as possible to the covenant. He testified that the $10 million covenant was negotiated "up front" so that Kalikow would be prepared to "deal with" Rupert Murdoch if he tried to come back into the market (tr., p. 59). The Division's claim that News America was barred from entrance into the newspaper market by the FCC rules rendering the covenant unnecessary is not supported by evidence in the record. News America operated the Post for two years under a temporary waiver of those rules. The waiver elapsed and News America did not seek to extend it or to make it permanent, but in 1993 News America received a second waiver which now allows it to operate the Post under a management agreement with KMI.

I. Petitioner notes that the $35.5 million value attributed to the real property by the Division leaves little value to be allocated to the remaining assets. The Division responds with the contention that the consideration exceeded $37,585,000.00, the total cash consideration recited in the Asset Purchase Agreement. According to the Division, KMI assumed certain obligations under section (3) of the Asset Purchase Agreement, and the assumption of these liabilities satisfies the definition of consideration found in Tax Law § 1440(1)(a).

KMI did not agree to assume the liabilities of News America under paragraphs (a), (b) and (c) of the Asset Purchase Agreement. Under paragraphs (b) and (c), KMI assumed certain contractual obligations under leases and contracts entered into by News America, but only to the extent that payment or performance under the contracts were for services or items rendered to KMI. KMI assumed no obligation for services or things provided to News America.

Paragraph (a) of section 3 is somewhat unclear concerning the liabilities to be assumed by KMI. It states that KMI agrees to assume the liabilities of News America as set forth in the working capital statement. That statement shows the excess of News America's total current liabilities over its total current assets as of March 7, 1988. The excess liabilities ($6,651,723.00) were included in News America's calculation of total loss from its sale of the Post. The contract and the working capital statement support Mr. Cremins's assertion that under paragraph (a) KMI agreed to collect outstanding receivables and satisfy outstanding accounts payable on behalf of News America with respect to obligations that became due and debts that became collectible before or after the closing date. The working capital statement evidences the basis for the dispute regarding the amount owed to News America after a reconciliation was completed. That dispute was finally resolved with the payment by KMI of $4,250,000.00. But the record does not establish that KMI agreed to or did assume the obligation to pay any debt of News America's under paragraph (a).

Under paragraphs (d) and (e) of section 3, KMI agreed to assume certain pension and severance obligations arising out of employee benefit plans. There is no question that this agreement had some value; however, it is not possible to determine the value of the agreement at the time of the transfer. Moreover, KMI's obligation to make payments was contingent upon the Post's cessation of operations, an event that has not occurred. The Division has offered no method for valuing KMI's agreement to assume the obligations arising out of the pension and other employee benefit contracts merely stating:

> "[T]here was a huge contingent liability for unfunded pension plans and the fact that the Post was running a multi-million dollar annual loss, both factors which negatively impacted the cash purchase price of the Post no matter what the value of its hard assets" (Division's brief, p. 20).

Whether the assumption of contingent liability for unfunded pension plans should be deemed additional consideration is relevant only if the answer calls into question the reasonableness of the apportionment of the consideration to the real property. In light of the contingent nature of the liability and the impossibility of valuing the promise at the time of the transfer, I cannot find that the assumption of those liabilities establishes that KMI and News America apportioned a disproportionate amount of the consideration to the real property.

J. The evidence in the record does not establish that at the time of transfer the fair market value of the real property was $35,500,000.00. The Division's valuation of the real property rests entirely on the Tishman Appraisal. The Division's expert witness, Mr. Lee, testified that in his opinion the Tishman Appraisal was thorough, reasonable and consistent with professional standards of appraisal. The Division argues that because it is the only contemporaneous appraisal of fair market value in the record it is entitled to great weight. It also asserts that the Cushman & Wakefield Appraisal and the Gordon Report are irrelevant since they were prepared after the transfer and do not reflect the market conditions that existed at the time the Post was sold. It makes the same point regarding the VRC report and states that the conclusions of the VRC report are suspect since it was prepared for the purposes of this litigation. It also points out that Banker's Trust relied on the Tishman Appraisal as collateral for its $25 million loan to Mr. Kalikow. I find none of these arguments persuasive.

The Tishman Appraisal's estimate of fair market value is based on certain assumptions made about the highest and best use of the property. For gains tax purposes, fair market value is defined as "the price at which a willing seller and a willing buyer will trade" (Matter of Bridgehampton Investors, Corp. supra). In some instances, a highest and best use analysis will forecast fair market value for the gains tax, but not in this case. There is no evidence that any buyer was willing to purchase the Post real property to use it for any of the purposes which the Tishman Appraisal determined to be its highest and best use: conversion to either residential or commercial office space. Kalikow did not purchase it for that purpose. Mr. Cremins credibly testified that he and Mr. Kalikow, both experts in real property development in Manhatten, did not believe that the Post real property could profitably be converted into either residential or commercial office space. The real estate market may have been in a speculative bubble in 1987 or the bubble may have burst by that time, but KMI and News America were not obligated by the gains tax law to value the Post real estate in accordance with what was obviously an overly optimistic appraisal.

In fact, the Tishman Appraisal stands out as the only estimate of fair market value that exceeds $16,000,000.00. The relative consistency of the other appraisals calls into question the reasonableness of the Tishman Appraisal. Mr. Reagan characterized Banker's Trust's reliance on the Tishman Appraisal as "a mistake". News America and Kalikow were not required by the gains tax law to make the same mistake.

K. In its brief, petitioner requested that its original purchase price be increased by $743,000.00, reflecting the amount paid Allen & Co. for its services in marketing the Post for sale. This expense was not claimed in News America's original filing, at the time of the audit or in the petition. Although News America's attorney solicited testimony regarding this expense, the Division was not apprised of petitioner's intention to request this addition to original purchase price even at the hearing and so did not have an opportunity to respond. I am deeming the request made in petitioner's brief to be a request to amend the petition, and I am denying that request.

Petitioner's attorney mentioned in his opening statement that petitioner would show that the Division incorrectly disallowed acquisition costs of $219,000.00 (see Finding of Fact "28"); however, he failed to follow up on this statement in his brief and the evidence at hearing was not sufficient to show that News America is entitled to the additional cost.

L. The petition of News America Publishing, Inc. is granted, and the Notice of Determination dated December 2, 1991 is cancelled.

DATED: Troy, New York
June 29, 1995

/s/ Jean Corigliano
ADMINISTRATIVE LAW JUDGE